Key Financial Secrecy Indicators

10: Harmful legal vehicles

What is being measured?

This indicator has two components. On the one hand, it shows whether the jurisdiction allows the creation of “protected cell companies” (PCC) in its territory. This type of company is also known as an “incorporated cell company” or “segregated account company”. On the other, it measures whether trusts with flee clauses are prohibited.

The main sources for this information are internet websites such as Lowtax.net, Ocra.com and Offshoresimple.com. These sources display the availability of protected cell companies either in a tabular or textual format. They have also helped us determine whether trusts with flee clauses are prohibited. In some cases the TJN-Survey 2011 also provided useful information. We have also referred to local regulators’ websites.

Protected Cell Companies are a rare type of corporate entity found almost exclusively in secrecy jurisdictions. Essentially a PCC is a corporate entity that contains within itself, but not legally distinct from it, a number of cells which behave as if they are companies in their own right, but are not. Every cell has its own share capital, assets and liabilities and the income and costs of each cell are kept separate. Moreover, each cell is assigned its own share of the overall company share capital so that each owner can be the single owner of one cell but owns only a percentage of the overall PCC.

As for the flee clause in trust agreements[1] (also termed flight clause), we have defined it in our glossary[2] as follows:

> “A flee clause is a provision included in a tax haven / secrecy jurisdiction trust deeds requiring that the management and administration of a trust be changed to a different jurisdiction if a disadvantageous event occurs such as the breakdown of law and order in the place in which the trust is administered or the imposition of taxation on the trust.”

Importantly, the definition of a “disadvantageous event” in this context includes awareness on the part of a trustee of any investigation involving the trust. The flee clause may mandate a trustee to relocate the trust from one secrecy jurisdiction to another as soon as anyone attempts to find any information about it, for example who the real people behind the trust are (beneficiaries and settlors). This mechanism allows the settlor or beneficiary to remain one step ahead of law enforcement authorities or private investigators and therefore provides factual impunity to users of trusts.

We award half a credit each if a jurisdiction does not allow the creation of protected cell companies and prohibits flee clauses.

Why is this important?

We are aware that PCCs originated in Guernsey in 1997 with the intention of providing a cost-saving mechanism for the reinsurance sector where many deals look much like one another, and where assets and liabilities need to be ring fenced to prevent inappropriate exposure to claims. We are also aware that PCCs are now readily available in locations such as the Seychelles and that they may now be used for other, illicit, purposes rather than that for which they were originally created. We think it likely that the level of asset protection that a PCC provides might allow illicit financial flows to escape the attention of law enforcement authorities. We therefore question whether the potential cost benefits these structures might allow to the reinsurance sector justify the broader risks and costs they impose on society at large.

The structure of PCCs has been compared to a house with a lock at the entrance and many rooms inside, each room locked separately with its own door, but also with an escape tunnel only accessible from inside the room. If an investigator seeks to find out what is going on in one room inside the house, she first needs to unlock the main outer door. But imagine that by opening that first door everybody inside the building is alerted to the fact that someone has entered the house. Anybody seeking to flee the investigator will be given enough time to do so thanks to the second lock at the individual room door. While the investigator tries to unlock the second door (by filing a second costly information request), the perpetrator has plenty of time to erase evidence and escape through the secret tunnel. This colourful metaphor neatly illustrates how a PCC might work in practice.

We have been advised that procedures to make international enquiries about PCC structures have not yet been developed by law enforcement agencies and there remain serious doubts about the effectiveness of current mutual legal assistance agreements when applied to them, meaning there is significant restriction in scope for law enforcement in this area. This is, of course, in part a function of the considerable opacity they provide in hiding potentially illicit activity behind a single corporate front.

PCCs can be used to conceal identities and obscure ownership of assets because what appears to be a minority ownership from the outside may in fact be an artificial shell purposefully created to conceal fully-fledged ownership of a cell within the “wrapper”.

Trust flee clauses are particularly obstructive of effective law enforcement. There are very few situations we can think of in which flee clauses are not useful for some kind of evasion of the consequences of illegal actions. The marketing and use of trusts as “asset protection” facilities including flee clauses often advertise the advantages in terms of “shielding” corporate assets from creditors, fleeing bankruptcy orders, spouses or inheritance provisions of the resident state of the settlor and/or beneficiary.

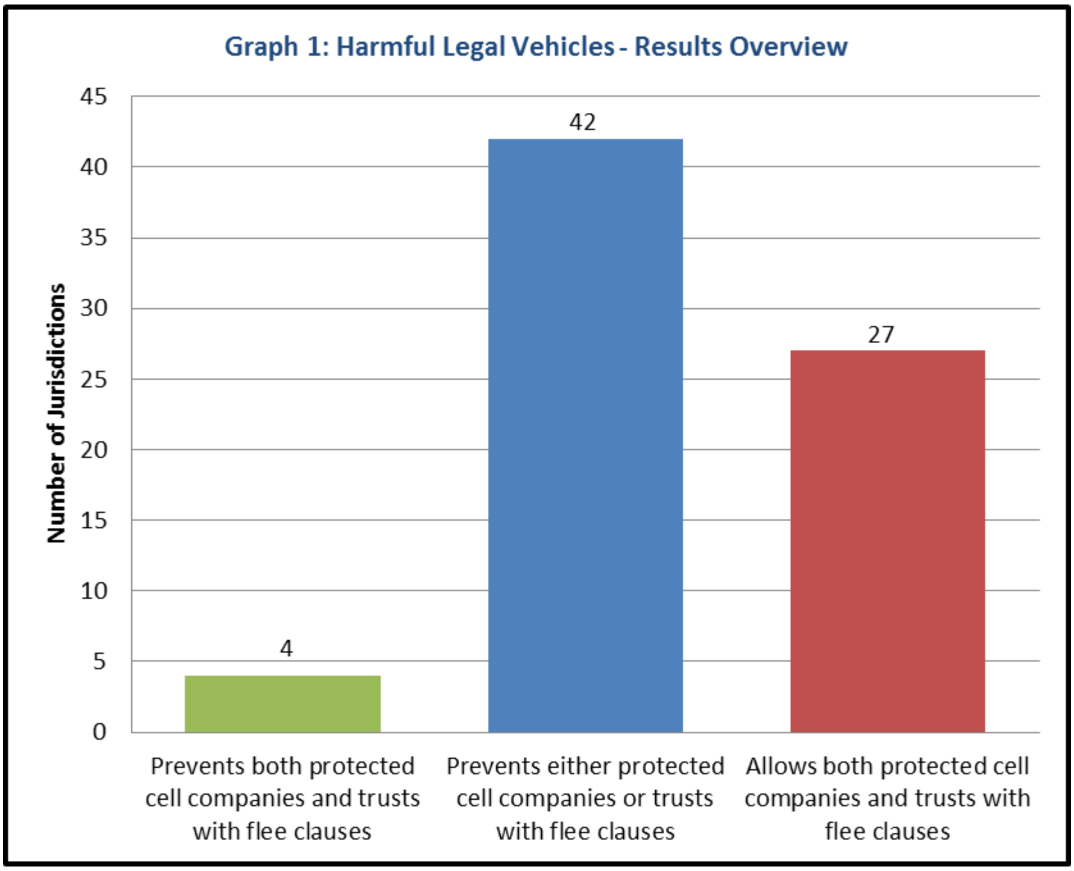
What are the crimes that might hide behind the availability of protected cell companies and flee clauses?

By enhancing "asset protection" through a double locked structure, protected cell companies can be used to shelter illicit assets from view and might therefore facilitate fraud, infringement of competition rules, tax evasion, aggressive tax avoidance, transfer pricing manipulation, non-payment of alimonies, hiding the proceeds of corruption, organised crime (especially drug trafficking), the illegal arms trade, trafficking in human beings, money laundering, the covering of illicit intelligence activity, bankruptcy fraud and more besides. The same holds true for flee clauses of trusts.

Results Overview

Table 1: Harmful legal vehicles - Overview

Number of jurisdictions that prevent both protected cell companies and trusts with flee clauses	4
Number of jurisdictions that prevent either protected cell companies or trusts with flee clauses	42
Number of jurisdictions that allow both protected cell companies and trusts with flee clauses	27



Results Detail

Graph 2: Harmful Legal Vehicles - Results Details

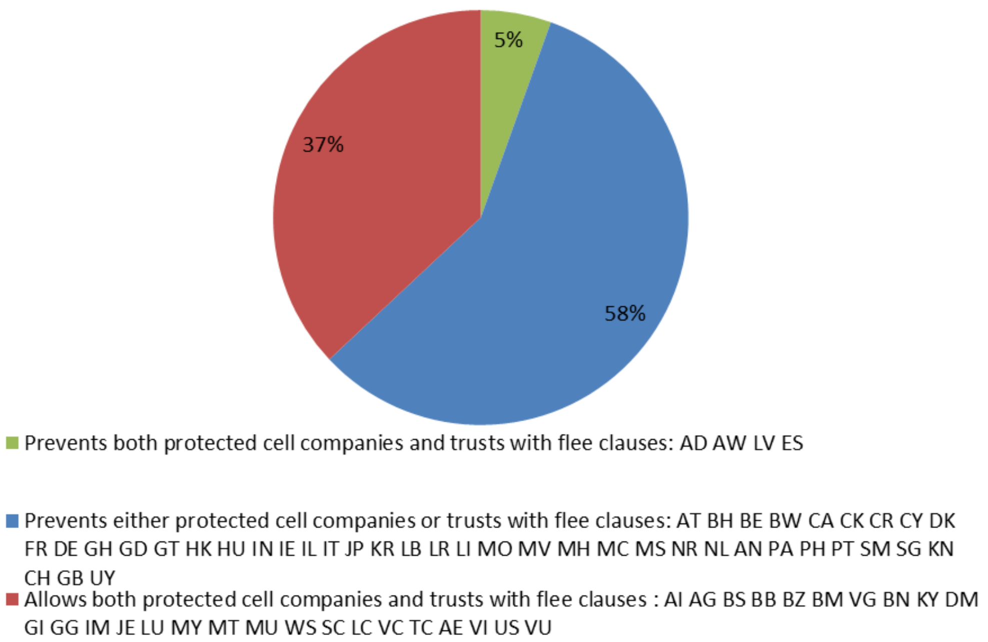


Table 2: Harmful Legal Vehicles - Details

ID	Jurisdiction	ISO	Prevention	ID	Jurisdiction	ISO	Prevention
1	Andorra	AD	Yes	38	Korea	KR	Partially
2	Anguilla	AI	No	39	Latvia	LV	Yes
3	Antigua & Barbuda	AG	No	40	Lebanon	LB	Partially
4	Aruba	AW	Yes	41	Liberia	LR	Partially
5	Austria	AT	Partially	42	Liechtenstein	LI	Partially
6	Bahamas	BS	No	43	Luxembourg	LU	No
7	Bahrain	BH	Partially	44	Macau	MO	Partially
8	Barbados	BB	No	45	Malaysia (Labuan)	MY	No
9	Belgium	BE	Partially	46	Maldives	MV	Partially
10	Belize	BZ	No	47	Malta	MT	No
11	Bermuda	BM	No	48	Marshall Islands	MH	Partially
12	Botswana	BW	Partially	49	Mauritius	MU	No
13	British Virgin Islands	VG	No	50	Monaco	MC	Partially
14	Brunei	BN	No	51	Montserrat	MS	Partially
15	Canada	CA	Partially	52	Nauru	NR	Partially
16	Cayman Islands	KY	No	53	Netherlands	NL	Partially
17	Cook Islands	CK	Partially	54	Netherlands Antilles	AN	Partially
18	Costa Rica	CR	Partially	55	Panama	PA	Partially
19	Cyprus	CY	Partially	56	Philippines	PH	Partially
20	Denmark	DK	Partially	57	Portugal (Madeira)	PT	Partially
21	Dominica	DM	No	58	Samoa	WS	No
22	France	FR	Partially	59	San Marino	SM	Partially
23	Germany	DE	Partially	60	Seychelles	SC	No
24	Ghana	GH	Partially	61	Singapore	SG	Partially
25	Gibraltar	GI	No	62	Spain	ES	Yes
26	Grenada	GD	Partially	63	St Kitts and Nevis	KN	Partially
27	Guatemala	GT	Partially	64	St Lucia	LC	No
28	Guernsey	GG	No	65	St Vincent & Grenadines	VC	No
29	Hong Kong	HK	Partially	66	Switzerland	CH	Partially
30	Hungary	HU	Partially	67	Turks & Caicos Islands	TC	No
31	India	IN	Partially	68	United Arab Emirates (Dubai)	AE	No
32	Ireland	IE	Partially	69	United Kingdom	GB	Partially
33	Isle of Man	IM	No	70	Uruguay	UY	Partially
34	Israel	IL	Partially	71	US Virgin Islands	VI	No
35	Italy	IT	Partially	72	USA	US	No
36	Japan	JP	Partially	73	Vanuatu	VU	No
37	Jersey	JE	No				

[1] An excellent introduction to trusts can be found in this blog: http://taxjustice.blogspot.com/2009/07/in-trusts-we-trust.html; 20.6.2011.
[2] http://www.secrecyjurisdictions.com/glossary; 20.6.2011.